BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

ANNUAL COMPLIANCE REVIEW, 2012   Docket No. ACR2012

REVISED RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO COMMISSION REQUESTS FOR ADDITIONAL INFORMATION
IN FY 2012 ANNUAL COMPLIANCE DETERMINATION

On June 26, 2013, the Postal Service submitted responses to requests for

additional information that the Postal Regulatory Commission included in its FY 2012

Annual Compliance Determination. Commission staff have notified the Postal Service

that attachments cited in the third and fifth responses are missing from the nonpublic

annex. The Postal Service is filing the missing attachments in nonpublic folder USPS-

FY12-NP42 today and has revised the third and fifth responses accordingly. The

revised responses follow; unredacted versions appear in USPS-FY12-NP42.

Respectfully submitted,

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3.   "The Commission concludes that the Postal Service must report within 90 days on whether the NSA that is the subject of Docket No. CP2013-38 complies with section 3633(a)(2). The Postal Service's report shall consist of the FY 2013 monthly financial results based upon the financial model previously provided to the Commission with its Notice in Docket No. CP2013-38, updated for actual volumes. The Commission also directs the Postal Service to modify its financial model for Global Plus NSAs to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated prices can generate sufficient revenues to exceed attributable costs. The Postal Service report shall describe the modifications implemented with respect to the financial model for Global Plus NSAs, and any other modifications in rates or service requirements likely to affect whether the NSA is in compliance with section 3633(a)(2)." (pp. 169-170)

RESPONSE:

The updated CP2013-38 financial, filed under seal in USPS-FY12-NP42, shows

that the NSA in Docket No. CP2013-38 complies with section 3633(a)(2) with a cost

coverage of ▮▮▮▮▮▮ %.

The model has updated inputs to provide more accurate costing projections. The

FY 2011 costs are replaced with data from the FY 2012 ICRA. Using a more recent

source for costs results in a more accurate forecast. The model also includes actual

volume and weight for January 2013 - March 2013 from PostalOne!. Including actual

volume for the time periods where such information is available reduces the potential

inaccuracy of the financial output compared to using a volume projection that is subject

to unexpected changes. Exchange rates are updated to the maximum value over a 12

month time period rather than the exchange rate on the date of filing the model. This

reduces the effect of a potential 'outlier exchange rate' on the filing date.

The following list outlines the updates made to the model:

- 02_Inputs
    - US Dollar per CDN Dollar exchange rate in [Ac] updated to the highest value from the past 12 months (1.0418 USD/CDN)

- o Total IPA and ISAL volume in [Ad] to [Ae] updated with FY2012 ICRA data
- o 'aip' weight and domestic transportation cost in [Af] to [Aj] updated with FY2012 ICRA data
- o Volume adjustment factors in [Aao] to [Aap]
    - Model includes actual volume for January 2013 - March 2013 in Period 1
    - Model forecasts volume for April 2013 - December 2013 in Period 2 - volume adjustment factors adjusted to reflect 9 month time period
- o Inflation Indices in [Bau] to [Dcp] updated with May 2013 Global Insights
- o Actual volume and weight for January 2013 - March 2013 added to model in cells [Acq] to [Bcs] - data from PostalOne!
- o Historical volume updated to reflect April 2012 to March 2013 and moved to cells [Act] to [Bcv] - data from PostalOne!
- o Contract Total Volume table added in cells [Acw] to [Bcy]
    - This table is used in calculations later in the model
    - Actual volume from [Acq] to [Bcs] is added to the product of the volume adjustment factors in [Aao] to [Aap] and the historical volume from [Act] to [Bcv]
- • 03_Processing_Costs
  - o IPA and ISAL processing costs in [Da] to [Eu] updated with FY2012 ICRA

Additionally, Attachment1.xls, filed under seal in USPS-FY12-NP41, proposes a

methodology to modify the ICRA model to more properly reflect the methodology used

in the CP2013-38 financial model. The proposal cannot be incorporated into the

financial model, but it is included to demonstrate that if the proposed methodology had

been in place in FY12, all of the contracts would have shown positive contribution.

In its response to Question 5 of Chairman's Information Request No. 8, Docket

Number ACR2012, the Postal Service explained that:

The Canada Post Corporation (CPC) rate schedules applicable to payments for Global Direct Entry Outbound Admail have detailed structures (such as per-piece charges that vary depending upon piece weight as well as machinability and presort incentives) that are not able to be explicitly considered in estimating the costs in the ICM Costing module of USPS-FY2012-NP2. As such, the treatment of the CPC charges was oversimplified; thus, the evaluation of costs for Global Direct Entry Outbound Admail was less accurate than would otherwise have resulted from a detailed analysis of mail tendered. The Postal Service is aware of the issue and plans to investigate options for obtaining better data or refining the calculations.

The "oversimplification" in the cost model for outbound Admail to Canada refers to the actual shape (long and short / small), weight per piece, and level of sortation data necessary to more accurately estimate the costs. The Canadian rate schedules are based on shape, weight per piece, and level of sortation and the investigation refers to the need to explore if those attribute data are available and how they can be incorporated into the model. The following proposal is the best option resulting from the investigation.

PROPOSAL:

Given that the Postal Service is invoiced by CPC on the aggregate product as a whole, it is proposed that the most accurate estimates of GDEO settlement payments for each NSA is to base payments on revenue shares rather than the current methodology of distributing the settlement costs by weight shares.

RATIONALE:

Accurately accounting for settlement costs by contract for GDEO Admail is made difficult because of the detailed CPC rate schedules for Admail. The settlement costs are by far the most significant cost element, so inaccuracy in the cost accounting by contract can lead to misjudging whether contribution is positive or negative. The ICRA currently allocates costs from aggregate (across customers) Admail settlement invoices which have in past ICRAs been distributed on a per-pound basis. Admail as a whole generated more revenue than its settlement costs plus estimated domestic handling and transportation. Using pound-shared settlement calculations led two contracts to have estimated negative contribution in ICRA 2012.

The issue is that contracts with negative contribution estimates may have performed better than estimated because the actual CPC rates are more complicated than a uniform per pound rate, and have different per piece costs based on the shipment average weight of the mail. The per piece changes break at 30g, plus for heavier items (over 50g) the schedule has an additional cost per gram. Costs also differ by degree of sortation. Below is an example from a recent financial model:

2012 Canada Domestic Admail Retail Rates in US Dollars

	[A]	[B]	[C]	[D]	[E]	[F]	[G]	[H]
	Short and Long (Up to 30 g)	Short and Long (Over 30 g up to 50 g)	Oversize (Up to 500 g)					
Admail Category	Rate per Piece	Rate per Piece	Rate per Piece	Rate per g Over 50 g				
[a] Machineable	$0.39	$0.41	$0.59	$0.0027				

	Short and Long (Up to 50g)
Admail Machinable Presort	Rate Per Piece
[b] Delivery Mode Direct (DMD)	$0.37
[c] Delivery Facility (DF)	$0.39
[d] Distribution Centre Facility (DCF)	$0.40
[e] Forward Consolidation Point (FCP)	$0.42
[f] Residue	$0.44

	Short and Long (Up to 100 g)		Oversize (Up to 500 g)		Oversize (500g to 750g)		Oversize (750g to 1.36 kg)	
Admail Letter Carrier Presort Rates	Rate per Piece	Rate per g Over 50 g	Rate per Piece	Rate per g Over 50 g	Rate per Piece	Rate per g Over 500 g	Rate per Piece	Rate per g Over 750 g
[g] Delivery Mode Direct (DMD)	$0.39	$0.0022	$0.47	$0.0027	$2.21	$0.0028	$2.92	$0.0033
[h] Delivery Facility (DF)	$0.42	$0.0022	$0.54	$0.0027	$2.27	$0.0028	$2.97	$0.0033
[i] Distribution Centre Facility (DCF)	$0.44	$0.0022	$0.55	$0.0027	$2.28	$0.0028	$2.98	$0.0033
[j] Forward Consolidation Point (FCP)	$0.54	$0.0022	$0.66	$0.0027	$2.40	$0.0028	$3.10	$0.0033
[k] Residue	$0.55	$0.0022	$0.67	$0.0027	$2.41	$0.0028	$3.11	$0.0033
[l] National Distribution Guide	$0.46	$0.0022	$0.61	$0.0027	$2.34	$0.0028	$3.04	$0.0033

	Dimensional Small (Up to 500 g)		Dimensional Large (Up to 500 g)	
Admail Letter Carrier Presort Rates	Rate per Piece	Rate per g Over 50 g	Rate per Piece	Rate per g Over 50 g
[m] Delivery Mode Direct (DMD)	$0.65	$0.0032	$0.73	$0.0032
[n] Delivery Facility (DF)	$0.81	$0.0032	$0.93	$0.0032
[o] Distribution Centre Facility (DCF)	$0.82	$0.0032	$0.94	$0.0032
[p] Forward Consolidation Point (FCP)	$1.32	$0.0032	$1.48	$0.0032
[q] Residue	$1.35	$0.0032	$1.51	$0.0032

Notes

Calculation: [Aa] to [Hq]: Corresponding rate from WP-GLOBAL_DIRECT_Pitney--05 * WP-GLOBAL_DIRECT_Pitney--02 [Ac]

In the FY 2012 ICRA, GDEO booked revenue was ▮▮▮▮▮▮ and estimated costs ▮▮▮▮▮▮. Two Global Plus Contracts were judged to have negative contribution in the ICRA. Both of these contracts had weights higher than other contracts and also in excess of those assumed in the financial model. However, the Postal Service rate schedules charged for GDEO account for the CPC complexity and mirror the schedule so that if the overall product provides positive contribution, so should the individual contracts. Things could go wrong if actual CPC rates are higher or have different

weight components than the financial models, or if for some reason too little revenue is collected from a customer. Inside the financial model, higher weight per piece in the ranges of what actually occurred for the two contracts with negative contribution show positive results.

The upshot is that, without knowing shipment-level details, it is more appropriate to allocate settlement cost based on revenue shares, which is easy to implement in the ICM Costing module. Since every rate component in the financial model is about ███████ percent higher than the CPC mail payment schedule, as long as the mail is charged correctly on the Postal Service side and invoiced back to the Postal Service based on the same assumptions, no matter the weight the mail should achieve a contribution near the average. The proposed enhancement reflects the reality of the considerations involved in developing the rate tables for the GDEO contracts.

IMPACT:

In the FY 2012 ICRA, GDEO contributions for the two Global Plus NSAs were judged to be negative. Revising the ICM Costing Module to use settlement costs per dollar of revenue, all contracts show positive contribution, which mathematically is what is expected based on the structure of the USPS GDEO pricing schedule. The non-public Excel file "Attachment 1.xls," filed under seal, displays: 1) the comparison between the FY 2012 Imputed version as filed in USPS-FY12-NP2 (Revised 2-8-13) and the proposed methodology, and 2) the comparison between the FY 2012 Booked version as filed in USPS-FY12-NP2 (Revised 2-8-13) and the proposed methodology.

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MECHANICS:

Attachment 1 consists of five tabs. The first tab, "GDEO Controls," provides the GDEO Admail revenue, pieces, and weights as received by the FY 2012 ACR Excel file, Inputs.xls. These aggregate totals are the basis for the calculation of the current average CPC settlement payment per pound, which is shown in cell B34. It is on the basis of that figure that the settlement payment total is currently distributed to individual NSA contracts based on the NSA weights.

Also shown on 'GDEO Controls' in cell B36 is the calculation of the proposed alternative basis for distributing the settlement payment total to individual GDEO NSAs. That figure represents the Canada Admail settlement payment per US Dollar of revenue charged to the NSA customer based on the USPS rate tables. As with all calculations in Attachment1.xls that are new and specific to this proposal, it is shaded green.

The "Imputed Version Before" tab provides GDEO NSA data by Contract Type, Docket, and Company Name from the Imputed version of the FY 2012 ICRA. This data was obtained from the Excel file "NSA Summary (Imputed) (Revised 02-08-13).xls", "PivotServer" tab, after filtering and reformatting. The negative contributions for the two Contracts discussed above are highlighted in red. The "Conveyance" amounts (CPC payments) were calculated in the ICRA by multiplying the Contract weight by the average CPC settlement payment per pound discussed above.

The "Imputed Version After" tab illustrates the proposed change in settlement costing methodology. In the green-shaded cells, the newly-proposed Canada Admail settlement payment per US Dollar of revenue is multiplied by the Contract revenue to obtain the estimated settlement payments. The cells shaded blue have merely had the

constant values that were shown in the "Imputed Version Before" tab replaced with simple formulas that recalculate total cost and Contribution based on the new Conveyance values, and also show the pertinent subtotals.

A comparison of the Before and After tabs for the Imputed version shows that: 1) all grand totals are identical before and after the methodology change, and 2) all Contracts show positive Contribution after application of the proposed methodology, as expected from the logic used in the Postal Service's preparation of the detailed GDEO rate charts.

The original GDEO NSA results by Contract Type, Docket, and Company Name from the Booked version of the FY 2012 ICRA are provided in the "Booked Version Before" tab of Attachment1.xls. This data was obtained from the Excel file "NSA Summary (Booked) (Revised 02-08-13).xls", "PivotServer" tab, after filtering and reformatting. They differ from the "Imputed Version Before" results only in that the Conveyance costs were benchmarked to control totals. The benchmark factor applied to the Imputed Conveyance costs is shown in the "GDEO Controls" tab, cell B38.

Because the proposed methodology leaves total Imputed costs unchanged, the same benchmark factor used to produce the original Booked results from the original Imputed results would apply in obtaining the "After" Booked results from the "After" Imputed results. This calculation is shown in the "Booked Version After" tab. While the Conveyance figures under discussion for this proposed methodology are shown shaded in green in "Booked Version After" in order to highlight them, the Booked version of the ICRA as it now stands would naturally produce these results from the modified version of the Imputed ICRA without requiring further change.

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As is the case for the Before and After Imputed results, it can be seen by comparison of the Before and After Booked results that: 1) all grand totals are identical before and after the methodology change, and 2) all Contracts show positive Contribution after application of the proposed methodology, as expected from the logic used in the Postal Service's preparation of the detailed GDEO rate charts.

5. "The Commission concludes that the Postal Service must report within 90 days on whether the successor China Post Group NSA that is the subject of Docket No. CP2013-23 complies with section 3633(a)(2). The Postal Service's report shall consist of the FY 2013 monthly financial results based upon the financial model previously provided to the Commission with its Notice in Docket No. CP2013-23, updated for actual volumes. The Commission also directs the Postal Service to modify its financial model for the China Post Group NSA to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated prices can generate sufficient revenues to exceed attributable costs. The Postal Service report shall describe the modifications implemented with respect to the financial model for China Post Group, and any other modifications in rates or service requirements likely to affect whether the NSA is in compliance with section 3633(a)(2)." (pp. 171-172)

RESPONSE:

The attached China Inbound Competitive model, filed under seal in USPS-FY12-NP42, shows that the NSA in Docket No. CP2013-23 complies with section 3633(a)(2) with a cost coverage of ▮▮▮▮▮▮ %.

The model uses updated inputs to provide more accurate costing projections. The FY2011 volume, weight, and costs are replaced with data from the FY 2012 ICRA. Using a more recent source for volume, weight, and cost results in a more accurate forecast. The Inbound EMS contingency percentage rate is further increased from ▮▮▮▮▮▮ % to ▮▮▮▮▮▮ % to show a more conservative forecast that includes an enhanced ability to account for future unexpected changes in volume, weight, or cost. The model also includes actual volume and weight for January 2013 - March 2013. Including actual volume for the time periods where it is available reduces the potential inaccuracy of the financial output compared to using a volume projection that is subject to unexpected changes. Exchange rates are updated to the maximum value over a 12 month time period rather than the exchange rate on the date of filing the model. This

reduces the effect of a potential "outlier exchange rate" on the filing date.

The following list outlines the updates made to the China Inbound Competitive

model:

- 01_Inputs
  - USD per SDR for Bilateral Agreement exchange rate in [Aa] updated to the highest value from the past 12 months (1.549481 USD/SDR)
  - EMS Contingency in [Ad]updated from ▮▮▮▮▮▮ % to ▮▮▮▮▮▮ %
  - Time period in [Be] to [Bg] referring to time period of cost data updated to reflect FY2012
  - Inflation Indices in [Bv] to [Dco] updated with May 2013 Global Insights
  - Volume adjustment factors in [Acp] to [Bcs]
    - Model includes actual volume for January 2013 - March 2013 in Period 1 - volume adjustment factors set to 'n/a'
    - Model forecasts volume for April 2013 - December 2013 in Period 2 - volume adjustment factors adjusted to reflect 9 month time period
  - EMS costs in [Act] to [Ecw] updated with FY2012 ICRA data
  - EMS pieces and weight in [Acx] to [Bda] updated with FY2012 ICRA data
  - Signature Confirmation and Delivery Confirmation costs in [Adb] to [Bdc] updated with FY2012 special studies
- 03_Dom_Tran_Inputs
  - Domestic transportation cost in [Ba] to [Eg] updated with FY2012 ICRA data
  - Product weight in [Ga] to [Gg] updated with FY2012 ICRA data
- 04_Stream_Mapping
  - Product volume and weight in [Ka] to [Lc] updated with FY2012 ICRA data
- 05_Product_Unit_Cost_Inputs
  - Unit costs in [Ab] to [Cc] updated with FY2012 ICRA data
- 08_Pieces-Wgt & TDues_Rates
  - Period 1 pieces and weight in [Ca] to [Dc] updated with actual January 2013 - March 2013 data from FPS